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Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Rulemaking to Amend Parts 1, 2, 21, and 25 Of the Commission's Rules to Redesignate The 27.5-29.5 GHz Frequency Band, To Reallocate the 29.5-30.0 GHz Frequency Band, To Establish Rules and Policies for Local Multipoint Distribution Service And for Fixed Satellite Services	)	CC Docket No. 92-297
	)	
Petitions for Reconsideration of the Denial of Applications for Waiver of the Commission's Common Carrier Point-to-Point Microwave Radio Service Rules	)	
	)	
Suite 12 Group Petition for Pioneer Preference	)	PP-22

PETITION OF WEBCEL COMMUNICATIONS, INC.
<u>FOR PARTIAL RECONSIDERATION</u>

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SUMMARY

WebCel applauds the Commission's decision in the *Second Report and Order* to bar incumbent local exchange carriers ("LECs") and cable system operators from acquiring Local Multipoint Distribution Service ("LMDS") licenses within their monopoly service territories. Yet, the *Second Report and Order* has a number of serious flaws that threaten to impede the effectiveness of the Commission's eligibility decision, deter small businesses from participating in the LMDS auctions, and undermine the Commission's principal goal in this proceeding – fostering LMDS as a robust competitor to incumbent LECs and cable operators.

First, without explanation, the Commission has eliminated the separate designated entity category for "very small businesses" eligible for discounts and bidding credits used by the Commission in the F block PCS and other recent spectrum auctions. Combined with the rejection of an asset test, *elimination of the very small business category improperly permits huge, well-capitalized communications companies (including the largest nationwide PCS licensees) and other asset-rich firms to acquire LMDS spectrum on the same financial terms offered to new, start-up entrepreneurial ventures.* The Commission should adjust its small business preferences for LMDS by reinstating a "very small business" category below the revenue threshold of $40 million for small businesses, by adding an asset test (that will help differentiate license and asset-rich entities from genuine start-ups like WebCel, to account for the significant cost of capital impediments very small businesses face in the communications industry), and by reinstating for very small businesses, financing at the preferential interest rate of 10-year Treasury obligations, as the Commission did in the F block auction.

Second, the *Second Report and Order* creates an exception to the rule of LEC and cable operator ineligibility for LMDS licenses by permitting these companies to participate in LMDS auctions for "in-region" Basic Trading Areas ("BTAs") on the condition that they "cure" any non-compliance within 90 days. This conclusion, never proposed for public comment, is procedurally and substantively infirm. Allowing incumbents to bid on in-region licenses, *sanctions the exact competitive mischief that the eligibility rule is designed to prevent* -- the ability to bid license prices above competitive levels and thereby keep LMDS licenses out of the hands of new entrants who would compete directly with the incumbents' local telephone and cable services. Incumbents can easily, and without any competitive or financial harm, acquire any permissible geographically partitioned licenses in the spectrum aftermarket. There is no reason whatsoever to undermine the eligibility rule by allowing them into the auction room to bid on licenses covering their service areas.

There are several other aspects of the *Second Report and Order* that merit reconsideration and revision, as well. *First,* the 20 percent "attribution" test adopted by the Commission will permit joint ventures and bidding consortia among incumbents -- for instance, among all five regional Bell Operating Companies -- in ways that defeat the efficiency of the auctions and increase barriers to LMDS competition. The Commission instead should apply the 10 percent attribution standard proposed in the *Fourth Notice* and supported by the vast majority of the commenting parties. *Second,* the Commission should include warrants and other convertible instruments as attributable interests for purposes of the eligibility rule. *Finally*, rather than delegating authority to set an auction date to the Wireless Telecommunications Bureau, the Commission should set a fixed auction date of no later than six months from today.

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PETITION OF WEBCEL COMMUNICATIONS, INC.
FOR PARTIAL RECONSIDERATION

WebCel Communications, Inc. ("WebCel"), by its attorneys and pursuant to Sections 1.429 and 1.4(b)(1) of the Commission's rules,[1] hereby petitions for partial reconsideration of the *Second Report and Order*[2] in the above-captioned docket.

[1] 47 C.F.R. §§ 1.429, 1.4(b)(1).

[2] *Second Report and Order, Order on Reconsideration, and Fifth Notice of Proposed Rulemaking,* Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules to Redesignate the 27.5-29.5 GHz Frequency Band, To Reallocate the 29.5-30.0 GHz Frequency Band, To Establish Rules and Policies for Local Multipoint Distribution Service And for Fixed Satellite Services, CC Docket No. 92-297 (released Mar. 13, 1997), 62 Fed. Reg. 23,148 (Apr. 29, 1997)("*Second Report and Order*").

INTRODUCTION

As the leading proponent of eligibility restrictions barring incumbent local exchange carriers ("LECs") and cable system operators from acquiring Local Multipoint Distribution Service ("LMDS") licenses within their monopoly service territories, WebCel is gratified that the Commission adopted eligibility limitations drawn largely from those WebCel proposed in 1996. If the FCC proceeds to implement these rules quickly and procompetitively, LMDS can finally achieve its potential as an important new source of local broadband competition for telephony, video and data services -- the Commission's "principal goal" in this proceeding.[3] Yet, the *Second Report and Order* also has a number of serious flaws, which the Commission should address on reconsideration, that threaten to undermine the effectiveness of the Commission's eligibility decision and to deter small businesses from participating in the LMDS auctions.

First, without explanation, the Commission has eliminated the separate designated entity category for "very small businesses" that are eligible for discounts and bidding credits, which was used by the Commission in the F block PCS, WCS, 800/900 MHz SMR, and other recent spectrum auctions. Combined with the rejection of an asset test, elimination of the very small business category improperly permits huge, well-capitalized communications companies (including the largest nationwide PCS licensees) and other asset-rich firms to acquire LMDS spectrum on the same financial terms offered to new, start-up entrepreneurial ventures.

Such a result is inconsistent with the Congressional mandate underlying the spectrum auctions and with the FCC's "designated entity" auction rules for most recent spectrum auctions. The Commission should adjust its small business preferences for LMDS by reinstating a "very

[3] *Second Report and Order* ¶ 126.

small business" category with a revenue threshold below the $40 million floor for small businesses, which would be eligible for unique preferences, and add an asset test that will help differentiate license and asset-rich entities from genuine start-ups like WebCel, to mitigate the significant cost of capital impediments very small businesses face in the communications industry. The Commission should also reinstate for very small businesses, financing at the preferential interest rate of 10 year Treasury obligations, as used by the Commission in the F block auction.

Second, the *Second Report and Order* creates an exception to the rule of LEC and cable operator in-region ineligibility for LMDS licenses by permitting these companies to participate and procure at auction such licenses on the condition that they "cure" any non-compliance within 90 days. This conclusion, never proposed for public comment, is procedurally infirm; as a substantive matter, it threatens to swallow the eligibility rule itself.

Contrary to the Commission's curious statement that precluding incumbents from bidding on in-region licenses will achieve "no compelling public benefit,"[4] allowing them to participate sanctions the exact competitive mischief that the eligibility rule is designed to prevent -- the ability to bid license prices above non-monopoly levels and thereby keep LMDS licenses out of the hands of new entrants who will compete directly with the incumbents' local telephone and cable services. Weighed against this serious competitive risk, which is identical to the reasons justifying the LMDS eligibility restriction in the first instance, there is no countervailing justification for allowing incumbent monopoly LECs and cable operators to bid on and acquire LMDS licenses at auction. Incumbents can either (a) purchase any permissible spectrum

[4] *Id.* ¶ 193.

holdings under the flexible geographic partitioning rules for LMDS in the aftermarket, at fair market value, or (b) divest their existing telephone or cable interests, in order to participate -- much like the Commission required in the recent DBS auction. Thus, incumbents suffer no harm from being excluded from in-region bidding, while the public interest and the LMDS eligibility restriction are directly undermined by their participation.

Finally, there are several other aspects of the *Second Report and Order* in which the Commission has failed to implement its vision of a competitive LMDS market that merit reconsideration and revision:

- The 20 percent "attribution" test, adopted based on an incorrect analogy between LMDS and Commercial Mobile Radio Services ("CMRS"), will permit joint ventures and bidding consortia among incumbents -- for instance, among all five regional Bell Operating Companies – and will dilute the efficiency of the auction and thereby decrease the likelihood of competition to incumbents. The Commission instead should apply, at a minimum, the 10 percent attribution standard proposed in the *Fourth Notice* and supported by the vast majority of the commenting parties.

- The *Second Report and Order* incorrectly concludes that warrants and other convertible instruments are not attributable for purposes of the eligibility rule, despite the Commission's conclusion in the context of its designated entity rules that convertible interests "have a present effect on the power to control the concern."[5] The likelihood of incumbent future ownership by a date certain, combined with covenants that typically accompany such forward deals, make it a virtual certainty that the full range of competitive mischief feared by the Commission from substantial incumbent ownership can easily be achieved through warrants and other convertible instruments.

- The *Second Report and Order* defers a decision on the LMDS auction date to the Wireless Telecommunications Bureau under delegated authority. This is inconsistent with the Commission's promise, reinforced by the relevant congressional committees, to bring LMDS rapidly to market. A firm and public auction date is crucial to the willingness of capital markets to fund prospective LMDS firms. The Commission should therefore set a fixed LMDS auction date at no more than six months from today.

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[5] 47 C.F.R. § 101.1112(d)(5).

DISCUSSION

I. THE LMDS DESIGNATED ENTITY RULES SHOULD INCLUDE A CATEGORY FOR VERY SMALL BUSINESSES

WebCel seeks reconsideration of the Commission's failure to include, without explanation or discussion, separate designated entity categories for "small businesses" and "very small businesses."[6] This tiered approach was successfully used by the Commission in the F block PCS auction, the recently completed WCS auction, and in the 800 MHz and 900 MHz Special Mobile Radio ("SMR") auctions, among others.[7] The *Second Report and Order* added a preferential treatment category for firms with $40 million to $75 million average annual revenue, but erred by omitting correspondingly larger bidding credits in the other direction, for very small businesses with less than $15 million in revenues. The Commission also eliminated the unique interest rate on installment payments for small businesses, i.e., the 10-year Treasury note rate, which was used in the F block auction. Instead, it adopted the same rate for all categories – large entrepreneurs and small businesses alike – of the 10-year Treasury rate plus 2.5 percent.[8]

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[6] The *Second Report and Order* established two separate categories for designated entities, each based on the annual average revenue of the applicant, together with controlling principals, over the preceding three years. The first category, akin to the entrepreneurial businesses category initially adopted by the Commission for the C and F "entrepreneurs' block" auctions (*See Fifth Report and Order*, Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket No. 93-253, 9 FCC Rcd 5532, 5581 ¶ 114 (1994)) (*"Fifth Report and Order"*), is for firms with average annual revenue of between $40 million and $75 million. The second category is for "small businesses" with average annual revenue that do not exceed $40 million. *See Second Report and Order* ¶ 348.

[7] *Report*, Section 257 Proceeding to Identify and Eliminate Market Entry Barriers for Small Businesses, GN Docket No. 96-113, ¶ 21 n.55 (released May 8, 1997)(*"Market Barriers Report"*).

[8] *Compare Second Report and Order* ¶ 349 *with Report and Order,* Amendment of Parts 20 and 24 of the Commission's Rules-Broadband PCS Competitive Bidding and the Commercial Mobile Radio Services Spectrum Cap, 11 FCC Rcd 7824, 7844 ¶ 42 (1996) (*"Spectrum Cap Order"*).

The elimination of a very small business category for LMDS and the separate interest rate applicable to very small businesses, represents a total loss of support for true entrepreneurship in the LMDS auction. By rejecting a separate category for very small businesses and adopting a common interest rate for all categories, the Commission fails to address the needs of truly small businesses that are well-suited to infuse competition into local monopoly markets through the acquisition of LMDS licenses. In doing so, the Commission reneges on the commitment it made earlier this month in the *Market Barriers Report* to continue to take steps to *eliminate* entry barriers and other burdens that discourage small businesses from participating in spectrum auctions.[9] Ironically, one of the methods touted by the Commission in its report was the adoption of special incentives to encourage the participation of small businesses in auctions, in particular "*tiered bidding credits and, in some cases, tiered installment payment plans.*"[10]

True start-up communications ventures like WebCel have a fundamentally different, and significantly higher cost of capital than more established communications firms, including asset and license-rich companies that (because they have yet to launch commercial services) may in the short run still have relatively small annualized revenues. By eliminating an asset test for small business bidding credits and by lumping pure entrepreneurs into a commingled designated entity category, the rules deflect investment away from true very small businesses and toward entities that already hold spectrum licenses and other assets valued in the hundreds of millions of dollars.

[9] *Market Barriers Report* at ¶ 149.

[10] *Id.* (emphasis added.)

In the absence of a separate category for "very small businesses," WebCel and other genuine start-up ventures seeking to compete for licenses in the LMDS auctions will continue to be *fundamentally* disadvantaged on a cost of capital basis *vis-à-vis* other, established communications firms which meet the *Second Report and Order's* revenue test for "small businesses," but in reality are anything but small. As indicated in the following chart, companies such as WinStar Communications, Inc. ("WinStar") and Associated Group, Inc. ("Associated"), which have current market capitalizations of $436 million and $716 million, respectively, and already hold extremely valuable spectrum licenses, initially would be in the same category as a newly formed entity that as yet has no facilities and provides no services, since like a start-up, these companies' average revenue over the last three years appear to be below the $40 million threshold. Similarly, NextWave Telecom, Inc. ("NextWave"), which successfully bid *$4.9 billion* in the C and F block auctions for national PCS licenses, and Omnipoint Corp. ("Omnipoint"), which has recently amassed WCS licenses in addition to its vast PCS holdings, would likewise appear to be eligible for the most favorable financial preferences in the LMDS auction.

FINANCIAL DATA FOR SELECTED WIRELESS FIRMS

	ART[11]	WinStar	Associated	NextWave	Omnipoint
Revenues					
CY (12/31/96)	$2,907,927	$68,048,000	$20,035,000	$ 0	$531,000
CY (12/31/95)	5,793	33,300,000	4,272,000	0	0
CY (12/31/94)	137,489	0	4,664,000	0	3,000,000
Avg. Revenue (3 Yr)	1,017,070	33,782,667	9,657,000	0	1,177,000
Assets (12/31/96)	36,648,701	290,223,000	518,018,115	4,906,064,067	1,419,472,000
Market Capitalization (as of 05/27/97)	186,200,000	436,158,750	716,025,625	NA	714,687,125

Note: Total assets for NextWave is the combined gross winning bids for licenses won at auction.
Other data derived from FCC and SEC public records.

[11]Advanced Radio Telecom

Providing *any* discount to firms that have assets valued at hundreds of millions if not billions of dollars and which hold licenses in major markets throughout the country flies in the face of the Congressional mandate underlying adoption of designated entity provisions -- to "ensure that small businesses . . . are given the opportunity to participate in the provision of spectrum-based services"[12] and to avoid "excessive concentration of licenses . . . by disseminating licenses among a wide variety of applicants, including small businesses."[13] Moreover, an ancillary benefit of assuring that licenses are widely disseminated is that the Commission would be adhering to fundamental principles of portfolio theory, thereby mitigating the Government's risk of bidder default, and lessening the likelihood that sound public policy would be held hostage to auction winners who are "too big to fail."

Offering existing licensees with far more substantial means the same level of discount as very small businesses, like WebCel, also contravenes Congress' admonishment in Section 309 of the Act that competitive bidding may not exclude small businesses from acquiring licenses or favor incumbents with "deep pockets" over "new companies or start-ups."[14] The undifferentiated approach of the *Second Report and Order* thus runs afoul of what the Commission has properly characterized as its "top priority" for spectrum policy, namely "[h]elping small businesses overcome the most significant hurdle to competition in the communications marketplace -- access to capital."[15]

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[12] 47 U.S.C. § 309(j)(4)(D).

[13] 47 U.S.C. § 309(j)(3)(B).

[14] H.R. Rep. No. 111, 103d Cong., 1st Sess. 254 (1993).

[15] *Spectrum Cap Order,* 11 FCC Rcd at 7846 ¶ 47.

The Commission should accordingly revise its LMDS designated entity rules to adopt the tiered bidding credit approach used in other recent spectrum auctions. In devising this approach for very small businesses in the F Block auction, the Commission emphasized that a tiered model *"will promote dissemination of licenses to a broader variety of applicants than a 25 percent bidding credit for all small businesses"* -- the approach that the Commission had previously taken in the C Block auctions.[16] The Commission explicitly sought to encourage the participation of smaller businesses in the auction, noting that "[c]reation of this subcategory of small businesses enables us to tailor our benefits to better meet the needs of bidders likely to participate in the F block auction."[17]

These same conclusions apply in full force to LMDS. Like F Block PCS, LMDS is a local, market-specific service that is uniquely well-suited to very small businesses. Although the *Second Report and Order* noted the "[s]ubstantial capital . . . required to acquire and construct LMDS systems,"[18] in reality LMDS is fundamentally a local, stand-alone service that does *not* require the acquisition of licenses in numerous contiguous markets in order to establish a commercially viable service. As such, potential LMDS bidders, such as WebCel, are classic entrepreneurs that can focus their capital-raising efforts on selected markets instead of broad, nationwide or regional entry. Furthermore, unlike mobile systems which require a licensee to

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[16] *Id.* at 7848 ¶ 53. Thus, in the F block auction, the Commission modified its rules so that entities with average three-year revenues of not more than $15 million would be eligible for a 25 percent bidding credit, and those with revenues of greater than $15 million but not exceeding $40 million would be eligible for a 15% bidding credit. *Id.* at 7849 ¶ 54. Firms with revenues exceeding $40 million up to the eligibility threshold of $120 million received preferential financing terms, but no bidding credits. *Fifth Report and Order* at 5581 ¶ 114.

[17] *Id.* at 7852 ¶ 60.

[18] *Second Report and Order* ¶ 348.

build out and simultaneously "turn on" an entire geographic market, LMDS operators can take a more incremental approach to build out of their systems, and hence have relatively lower start-up costs, and less burdensome capital requirements, than bidders in the C Block auctions.

In adding a category for firms with revenue between $40 and $75 million, the Commission analogized LMDS to the broadband PCS entrepreneurs' block auctions where, according to the Commission, "the considerable capital needed to bring service to the public justified special provisions for entities with financial means greater than $40 million in average gross revenues.[19] WebCel does not quarrel with the conclusion that *there is a place in the LMDS business for larger new entrants.* However, as with the F block auction, where the Commission had both a very small business category and categories for significantly larger general entrepreneurs, *the unique needs of very small businesses should be addressed in a separate category.*

The fundamental inequity, both to true small businesses and to the U.S. Treasury of allowing extraordinarily well-capitalized, asset-rich companies -- such as ART, Associated, WinStar, Omnipoint, and NextWave -- to receive the *most favorable* LMDS bidding preferences available should be remedied as follows:

- *First,* the Commission should adopt for the LMDS auctions the "very small business" designated entity category used for the F block auctions for firms with average revenue of less than $15 million over the previous three years.[20] As with the very small business category in other services, firms in this category should receive a higher bidding credit than the small business category. The Commission can implement this higher bidding credit for very small businesses in one of two ways.

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[19] *Id.* ¶ 348.

[20] *Spectrum Cap Order* 11 FCC Rcd. at 7852 ¶ 60.

(1) the Commission can leave the bidding credits for the two existing categories unchanged, and adopt an increased bidding credit of 35 percent for very small businesses (applying the 10 percent bidding credit differential between the small business and very small business categories used in the F block rules); or

(2) the Commission can adopt the same three-part scheme adopted in the F Block auction -- a 25% bidding credit for very small businesses, a 15 percent bidding credit for small businesses, and no bidding credit for designated entities with revenues greater than $40 million.

- *Second,* under the LMDS rules, bid payments for all designated entities, regardless of category, are financed at the same interest rate – the rate on 10-year Treasury obligations plus 2.5 percent. WebCel believes that instead, the Commission should reinstate for *very* small businesses, as was the case in the F block auction, installment payments at the rate for ten year Treasury obligations, thereby "providing small businesses with the appropriate level of U.S. government assisted financing to overcome the difficulties faced in accessing capital to compete in the . . . marketplace."[21]

- *Third,* the Commission should also impose a "financial eligibility threshold" on designated entity status akin to that adopted for the C and F block auctions, which barred firms from participating in the entrepreneur's block that had total assets in excess of $500 million.[22] This would effectively preclude firms with substantial communications holdings or other assets but relatively modest revenues, from taking advantage of commingled and undifferentiated discounts with true entrepreneurs.[23]

The Commission's elimination of an asset test for LMDS small businesses presumably stemmed from its recognition that application of asset restrictions in a market characterized by complex financial relationships can be difficult. WebCel therefore believes that the most

[21] *Id.* at 7844-45 ¶¶ 42, 44.

[22] Under that threshold, other licenses (such as SMR, narrowband PCS, broadband PCS A and B blocks, and cellular), were included in an entity's total asset calculation for purposes of determining whether it met the asset test for participation in the F block auction. *Id.* at 7839 ¶ 27. The Commission, however, declined to include C block licenses as assets that could potentially preclude C block winners from F block eligibility. This would be "unfair" according to the Commission, because, as the Commission had indicated previously, "the C and F blocks are linked" occupying contiguous spectrum that could be efficiently aggregated by entrepreneurs. Of course here, there is no similar linkage between LMDS and any other allocation akin to that between the C and F blocks.

[23] *Id.* at 7838 ¶ 25.

administratively simple approach, and one that meets the congressional directives for spectrum auctions in Section 309 of the Act, is to apply to LMDS the same tiered preferences, with a separate discount schedule for very small business, adopted in the F Block PCS auction, as well as a preferential interest rate for very small businesses equal to the rate on ten year Treasury obligations. Even if the Commission reaffirms its rejection of an asset test, at the very least a bidding credit differential for very small businesses ($15 million or less) and preferential financing (10-year Treasury obligation rate), are clearly vital to the participation of truly entrepreneurial firms in the LMDS auction.

II. LECS AND CABLE OPERATORS SHOULD, AT A MINIMUM, BE REQUIRED TO DIVEST THEIR OVERLAPPING TELEPHONE OR CABLE FACILITIES AS A CONDITION OF BIDDING ON IN-REGION LMDS LICENSES

In the *Second Report and Order* the Commission adopted an eligibility restriction prohibiting incumbent LECs and cable operators from holding 1,150 MHz LMDS licenses in BTAs that overlap more than 10 percent of their service areas. This was clearly the correct decision, for which the Commission supplied a reasoned basis, supported by economically grounded reasoning and a comprehensive record.[24]

[24] *See Cincinnati Bell Telephone Co. v. Federal Communications Commission,* 69 F.3d 752 (6th Cir. 1995). The Commission's decision that an eligibility restriction is required began with an observation, which the Commission had made "unanimously . . . in recent proceedings," that cable operators and LECs have "substantial market power." *Second Report and Order* ¶ 163. That market power, according to the Commission, will not abate any time soon, and certainly not by the time LMDS systems are licensed, constructed, and begin service. Indeed, the Commission emphasized that *any assertion that "meaningful competition" will arise in the near term from any of the host of firms that today are often touted as competitors to cable operators and LECs, "requires a great deal of speculation." Id.* ¶ 164.

The Commission found that as "dominant firms," LECs and cable companies have the incentive and ability to "block entry" and "preempt competition in their respective markets" through the acquisition of LMDS licenses, thereby "perpetuat[ing] the status quo" and handicapping the pro-competitive benefits of licensing this new service. *Id.* ¶¶ 166, 173, 175. For example, the Commission found that incumbents could forestall the deployment of competitive LMDS facilities by obtaining an LMDS license and limiting its uses to those that complement its current operations, rather than that compete with them. In this manner, incumbents can both "protect their market power" and preserve a stream of excess future profits that "an independent LMDS competitor would erode." *Id.* ¶ 163.

At the same time, however, the Commission concluded that there is "no compelling public benefit to be achieved" by precluding incumbent LECs and cable systems from "participating fully" in the auctions for this spectrum.[25] The Commission ruled, instead, that these monopoly providers should be allowed to bid at auction for LMDS spectrum if they come into compliance with the eligibility restrictions within 90 days from the final grant of an LMDS license.[26] Under the Commission's rule, incumbents can come into compliance by partitioning the conflicting portion of the license and, within the 90-day window, filing an application to assign or transfer that portion to another entity.

This loophole in the eligibility restriction to allow incumbents to bid on in-region licenses was never proposed in any public notice or comment phase of this proceeding, and is thus procedurally infirm. As a substantive and policy matter, it cannot be reconciled with the record evidence and economic analysis supporting the Commission's finding that imposition of eligibility restrictions on incumbent LECs and cable operators "is both prudent and reasonable."[27]

Based on its expert judgment, supported by a thorough economic analysis, the Commission predicted that absent an eligibility restriction, "incumbents are likely to be high bidders for LMDS licenses" given that "the monopolist has a greater incentive to preempt than an entrant has to enter." *Id.* ¶¶ 173, 175. The Commission also found that "preemptive acquisition is particularly compelling here" given the unusually large size of the LMDS spectrum allocation. *Id.* ¶ 173. In sum, the Commission found that the failure to adopt an eligibility restriction that addresses the incentive and ability of incumbent firms to pursue such foreclosure strategies, would result in the loss of a "rare" and a "valuable" opportunity to "introduce competition into concentrated markets characterized by firms with substantial market power." *Id.* ¶ 169.

[25] *Second Report and Order* ¶ 193.

[26] *Id.* ¶ 194.

[27] *Second Report and Order* ¶ 165.

By allowing incumbents to bid on in-region licenses, the FCC creates a gaping loophole in the eligibility restriction that threatens to swallow the restriction itself. The *Second Report and Order* recognizes the reality that incumbent LECs and cable companies will value LMDS higher than fair market value, because they "have the additional incentive to protect their market power and preserve a stream of future profits."[28] This is a very serious problem because, as the Commission found, such supra-competitive values will distort the LMDS auctions, raise the price for LMDS licenses above competitive levels, and serve to exclude competitive LMDS providers.[29] It is this auction-distorting effect of LEC and cable company participation that the Commission's 90-day cure rule not only allows, but exacerbates.

Allowing incumbents to bid does nothing to blunt the incentive and ability of the incumbents to "block entry" and "preempt competition in their respective markets"[30] by manipulating the process, inflating the price of LMDS licenses, deterring entry by potential competitors, and creating additional hurdles to the already difficult task of capital-raising by smaller, entrepreneurial LMDS auction participants. In particular, monopoly LECs and cable systems could:

- Bid on and win *any* in-region BTA under the guise of a commitment to later divestiture -- even those which overlap their monopoly territories well in excess of the 10% threshold precluded by the Commission's LMDS eligibility

[28] *Id.* ¶ 171.

[29] *Id.* ¶ 175 (incumbents likely to be high bidders for LMDS licenses because, as monopolists, they stand more to lose than a new entrant has to gain, and therefore have a greater incentive to preempt than an entrant has to enter). *See also Second Report and Order,* Amendment of the Commission's Rules to Establish New Personal Communications Services, 8 FCC Rcd 7700, ¶ 99 (1993) ("*Broadband PCS Second Report*") (value of PCS licenses to the incumbent providers would be their continued economic rents which could be higher than the anticipated profits of any new entrant into a more competitive market and incumbent firms may thus be willing to pay even more for the chance to impede entry than for the chance to compete vigorously against new entrants).

[30] *Id.* ¶ 166.

rules -- and pursue strategies designed to prevent entry by a competitive LMDS provider or otherwise delay commercialization of LMDS in the same manner as the spectrum "warehousing" prohibited by the *Second Report and Order*. For example, winning incumbents could:

(1) file post-auction waiver applications on the putative ground that the market is competitive, thereby delaying (perhaps even past the eligibility rule's sunset) or outright preventing transfer of the overlapping segment;

(2) fail to make the 90-day divestitures required to comply with the eligibility restriction, and though defaulting on the deposit, thereby delay deployment of a competitive LMDS system; [31]

(3) subsequently partition and sell, even at a substantial loss, to allied entities or other "friends" who do not present a risk of direct competition with core monopoly services; and

(4) transfer the LMDS license to a trustee, certifying, as permitted by Section 101.1003(f)(1)(C) of the new LMDS rules,[32] that it has been unable to find a buyer (which will likely be impossible at the monopoly bid prices to be expected from incumbents), thereby evading the 90-day cure rule, altogether;

- Engage in sham bidding for LMDS auctions within their monopoly territories solely to drive-up prices above competitive levels and increase network capital costs for their LMDS competitors beyond levels at which it is economically feasible for new entrants to take monopoly share away from incumbents.

The sole basis for the Commission's decision to let incumbents bid subject to a 90-day cure was reply comments of the Federal Trade Commission ("FTC") staff that in no way support the rule ultimately adopted. There, the FTC suggested that a cable operator owning a system entirely within a BTA should be able to *sell that cable system* to avoid competitive problems associated with an overlapping LMDS interest. *There is absolutely no support in the record, and*

[31]Default of the auction deposit is a small price to pay, particularly for monopolists with billions of dollars in financial assets, for delaying, obfuscating or outright stifling the licensing of LMDS competitors.

[32]47 C.F.R. § 101.1003(f)(1)(C).

certainly none in the FTC's comments, for the proposition that the incumbent should be able to comply with the eligibility restriction by selling the overlapping portion of the LMDS license.

Incumbent LECs and cable operators can bid on in-region BTAs by divesting their overlapping telephone and cable facilities in advance of the auction or by a date certain following completion of the auction. This is the same approach that was adopted by the Commission -- and recently affirmed by the D.C. Circuit -- in connection with its auction of licenses for Direct Broadcast Satellite channels at one of three orbital locations capable of reaching the entire continental United States ("full-CONUS").[33] In the *DBS Report and Order,* the Commission adopted a rule prohibiting firms holding DBS licenses at a full-CONUS location from acquiring at auction licenses for another full-CONUS location. While not barring existing licensees from participating in the auction of the additional full-CONUS slot, the Commission required these licensees to divest their existing interest in full-CONUS slots as a condition of acquiring licenses for the full-CONUS slot being auctioned. Likewise here, the only circumstances under which LECs and cable systems should be able to bid on in-region BTA licenses is if they divest their existing facilities, before the auction or by a date certain.

Given the grave competitive concern with allowing incumbents to own in-region LMDS licenses, the *Second Report and Order* suggests nothing that would weigh in favor of allowing incumbents to participate in the auction of in-region licenses. The availability of both partial and complete geographic partitioning by LMDS auction winners is clearly adequate to support any legitimate entry strategies by LECs and cable

[33] *Report and Order,* Revision of Rules and Policies for the Direct Broadcast Satellite Service, IB Docket No. 95-168 and PP Docket No. 93-253, 11 FCC Rcd 9712 (1995) (*"DBS Report and Order"*), *petition for review denied, DirecTV v. Federal Communications Commission,* No. 96-1001 (D.C. Cir. Apr. 18, 1997).

companies. *Incumbents will have the same right as any other entity to acquire LMDS licenses post-auction at fair market value -- and can do so for the non-overlapping portions of their service areas that do not infringe on the Commission's eligibility restrictions*. As the Commission recently recognized, geographic partitioning adequately meets the needs of small firms that, as a financial matter, cannot afford to participate in auctions by permitting after market acquisition of licenses for smaller geographic areas.[34] Obviously, if geographic partitioning and after market purchase are sufficient for small entities who can only afford to purchase small geographic areas, they are likewise sufficient for incumbent LECs and cable operators, who are legally precluded from acquiring licenses for the larger geographic area in the face of compelling competitive concerns.

Thus, denying incumbent LECs and cable companies the ability to bid on in-region LMDS licenses will impose no economic penalty on them and will realize the profound public benefit of ensuring that LMDS auction prices are not bid up to monopoly levels, pricing new entrants out of the market. In contrast, allowing ineligible entities to bid for LMDS licenses subject to later partitioning and divestiture of the overlap will only create distortions in the efficiency of the LMDS auctions by permitting incumbent monopolists to "game" the process in order to drive up license prices and deter potential competition.

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[34] *Market Barrier Report* ¶ 115.

III. SEVERAL OTHER ASPECTS OF THE *SECOND REPORT AND ORDER* MERIT RECONSIDERATION AND REVISION

A. LEC and Cable Ownership Interests In LMDS Licensees of 10 Percent or Greater Should Constitute an Attributable Interest Under The Eligibility Restriction

In the *Second Report and Order*, the Commission found that an ownership interest of an incumbent LEC or cable operator in an LMDS licensee is not "attributable" for purposes of the eligibility restriction unless the incumbent owns 20 percent or more of the LMDS operator. In doing so, the Commission rejected its tentative conclusion in the *Fourth Notice,* overwhelmingly supported by the comments, to adopt a far more competitively prudent rule that would attribute ownership interests of incumbents of 10 percent or more.[35]

In an effort to support the 20 percent rule, the Commission proffers a number of conclusory justifications that cannot withstand serious scrutiny.[36] In fact, the 20 percent rule simply cannot be reconciled with the competitive risks arising from incumbent LECs and cable operators ownership of LMDS licenses covering their service areas highlighted by the Commission in the *Second Report and Order.*

[35] *First Report and Order and Fourth Notice of Proposed Rulemaking,* Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules to Redesignate the 27.5 -29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services, CC Docket No. 92-297, ¶ 133, (rel. July 22, 1996) (*"Fourth Notice"*).

[36] Two of these justifications are little more than non sequiturs. The Commission argues that "increased flexibility [from a 20 percent benchmark] will enable LMDS providers to adapt their services to meet customer demand." However, this statement simply makes no sense. Neither the Commission nor logic can explain any correlation between an attribution rule and the ability of LMDS providers to adapt their services to meet customer demand. The Commission also argues that a 20 percent rule will facilitate a wide variety of service providers to enter the market. This too, makes no sense. Nothing in the Commission's rules prevents LECs and cable operators from investing fully in LMDS outside their service territories. Moreover, as discussed *supra*, the public interest would be ill-served by LECs and cable operators acquiring LMDS licenses in-region. Rather than promoting the competitive delivery of wireless services, such entry would undermine competition. See *Second Report and Order* ¶ 190.

In asserting that the 20 percent attribution standard strikes the proper balance between encouraging capital investment and business opportunities and guarding against potential competitive harms,[37] the Commission nowhere explains how a 10 percent rule comes up short in this regard, nor points to any record evidence addressing the affects of a 10 percent rule on LMDS capital formation. To the contrary, a 20 percent standard further undermines the LMDS eligibility restriction (already rendered largely impotent by the Commission's decision to let incumbents participate in the auction subject to divestiture), deemed necessary due to the competitive risks of LEC and cable system LMDS ownership discussed in the *Second Report and Order*.

With a 20 percent attribution limit, incumbent LECs and cable operators have virtually unlimited flexibility to pursue competitive foreclosure strategies. The 20 percent rule invites incumbents in different markets to form bidding consortium and other ventures to bid on LMDS licenses in their respective regions in order to circumvent the eligibility rule. *Under this standard, the five regional Bell Operating Companies are permitted to form a wholly-owned joint venture for LMDS, allowing the same anticompetitive auction tactics and spectrum warehousing the eligibility rule is designed to prevent.* As predicted by the Commission's economic theory underlying the need for an eligibility restriction, the common and unified interests of incumbents virtually guarantee that such consortia would be the high bidders for licenses in its members' markets, thus almost ensuring that LMDS licenses won by these consortia would be used for anything but direct competition, and likely leading to significant concentration of LMDS licenses in a handful of incumbents.

[37] *Id.*

One rationale suggested by the *Second Report and Order* for a 20 percent attribution rule is that, because the same rule was used for attributing ownership interests in CMRS licenses, "there are good reasons to adopt [LMDS] rules that are consistent with existing rules governing wireless services licensees."[38] This rationale sacrifices competition in the name of administrative expediency. The Commission recognized in the *Fourth Notice* that there is a wide variation in the attribution rules applied to various services,[39] much of which arises from the particular market structure issues that the underlying service rules address. Thus while a 20 percent attribution standard may have struck the appropriate balance for CMRS, several factors which distinguish LMDS from the broader CMRS context counsel that the 20 percent standard is far too liberal a basis for determining the permissible level of LEC and cable operators ownership of in-region LMDS licenses.

Unlike CMRS, the LMDS attribution rules are aimed exclusively at incumbent cable operators and LECs -- entities that the Commission has repeatedly recognized as having substantial market power.[40] In contrast, as the Commission found in its recent *CMRS Competition Report,* the CMRS market is relatively competitive.[41] Thus, the CMRS rules are more concerned with preventing incremental increases in concentration in a relatively competitive market, while the LMDS rules in contrast are designed to preserve a "rare" and a

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[38] *Id.* ¶ 191.

[39] *Fourth Notice* ¶ 133.

[40] *See supra* at 12, n.24

[41] *Second Report,* Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993. Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, FCC 97-75 (rel. Mar. 25, 1997).

"valuable" opportunity to "introduce competition into concentrated markets characterized by firms commanding market power."[42]

The competitive landscape is clearly more extreme in the LMDS context as compared to the diversified CMRS market. Indeed, it was these similar heightened competitive concerns that led the Commission to adopt a *5 percent* attribution rule in the context of the DBS auction discussed above. In that proceeding, the Commission designed an attribution standard to ensure that new licensees would be truly independent from incumbents and would be "in a position to provide vigorous competition to them."[43] It should do the same here.

The Commission's decision to reject the 10 percent attribution rule is also inconsistent with the Telecommunications Act of 1996 and the Commission's stated preference to "adopt definitions drawn directly from the statute."[44] Thus, as the Commission recognized in the *Fourth Notice*, a 10 percent attribution standard tracks Section 652 of the 1996 Act (generally prohibiting incumbent LECs and cable operators from acquiring attributable interests in each other), which "has the same goals as [the FCC] in this proceeding."[45] Similarly concerned about the same types of competitive incentives at issue here, Congress defined ownership and affiliate in the 1996 Act to mean an interest of 10 percent or greater.[46] Therefore, on this basis alone, an attribution standard of 20 percent is not defensible.

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[42]*Seecond Report and Order* ¶ 169.

[43]*DBS Report and Order* at 9746 ¶ 88. In particular, the Commission adopted the 5 percent threshold to ensure that licensees at different full-CONUS locations would have neither the incentive nor the ability to influence the behavior of one or both of them or to modify their conduct to maximize their joint profits rather than compete against each other. *Id.* at 9747 ¶ 93.

[44] *Second Report and Order* ¶ 185.

[45]*Fourth Notice* ¶ 133.

[46]*See* 47 U.S.C. § 153(1)(defining the terms "affiliate" and "own").